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501.19-00

513.05-00

Form 886-A (Rev. May 1980)	EXPLANATION OF ITEMS	Schedule No. or Exhibit
Name of Taxpayer:		Year/Period Ended
		and

FACTS:

The [redacted] of the [redacted] (also referred to as the Post) was incorporated on [redacted] as a nonprofit corporation under the laws of the state of [redacted]. It is affiliated with the [redacted], and was recognized as exempt from Federal income tax as a subsidiary of the national organization by our group ruling letter dated [redacted]. Both the national organization and the affiliated subordinates covered by the group ruling are described in Internal Revenue Code section 501(c)(19).

The Post's purposes as set forth in Article 3 of its Articles of Incorporation are "To promote cooperation in all matters of interest to the veterans and their families and servicemen of the communities of [redacted] and [redacted] and surrounding territories; to develop an increased civic interest; to create and maintain higher standards in business dealings; to correct trade abuses; to compile and distribute information to its members for their benefits; and to aid and protect its members. In conjunction with the above purposes, the Post operates social and recreational facilities, including a bar and lounge, as well as a card room for its members and their guests. In addition, the Post's facilities are made available for social occasions such as parties, family reunions, and other similar type functions.

In the past, the Post conducted activities for the members, including family outings and other get-togethers, as well as civic activities to commemorate veterans holidays such as Memorial Day and Fourth of July. In addition, the Post conducted weekly bingo games and used a portion of the proceeds to provide financial support for community charities such as holiday food programs. In recent years, however, the Post's civic and patriotic type activities have been discontinued due to lack of participation and financial constraints. In addition, the Post no longer holds its bingo games formerly conducted on a weekly basis.

With respect to the Post's bingo activities, the bingo games were investigated by law enforcement officials in [redacted], and found to be conducted by a bingo promoter in violation of the state laws governing such operations in the state of [redacted]. We were advised by members of the Post's Board of Directors that the bingo games were raided by law enforcement officials from [redacted] in [redacted], and as a result of the law enforcement raid, the Post agreed to relinquish its bingo license, thus, effectively negating the conduct of further bingo games for at least one year and possibly longer.

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Name of Member:		Year/Period Ended
		and ---, ---, ---

The Post is a membership organization with two membership categories. The first category consists of the regular veteran members which currently number approximately and the second category consists of the social members which currently number approximately. The distinction between the two membership categories is self-evident. Regular members must be veterans of the United States military services while no such requirement exists for the social/guest members who generally have no prior military service. With respect to the two membership categories outlined above, for dues purposes the Post collects \$20 annually per veteran member, of which \$15 is remitted to the A. Membership dues in the amount of \$30 are collected annually from the social/guest members, none of which is remitted to the National Headquarters.

For membership accounting purposes, a list of the veteran members is maintained on a roster compiled at the National Headquarters from a database of National members, a copy of which is printed and provided to the Post annually. Inasmuch as no annual dues are paid to the for the social members, their names are not maintained in the National member database, and thus, do not appear on the regular veterans membership roster. A separate list of social members is maintained on a roster kept at the local Post.

As noted above, the Post's membership constituency consists of two separate and distinct categories: (1) Veterans and (2) Social (Guest Members). Numerically, for the calendar years covered by this examination, the Post's membership consisted of 3 percent social members in the calendar year, 1 percent in, and percent in. We were advised during the examination that the Post was aware of the proscription against social members in veterans organizations such as an but nevertheless, has had social members for at least six years and probably longer.

This examination report considers whether the Post may accept social/guest members into its membership ranks and still maintain its status as an organization recognized as exempt from Federal income tax under the provisions of Internal Revenue Code section 501(c)(19).

Secondarily, this report considers whether the Post's bingo operation constitutes an unrelated trade or business activity that should be subject to the unrelated business income tax imposed by the Internal Revenue Code.

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Name of Taxpayer		Year/Period Ended and

LAW:

Internal Revenue Code Section 501(a)
Internal Revenue Code Section 501(c)(19)
Income Tax Regulations Section 1.501(c)(19)-1(b)
Revenue Procedure 80-27, 1980-1 C.B. 677

Internal Revenue Code section 501(a) provides exemption from taxation for organizations described in subsection (c). Internal Revenue Code section 501(c) provides a list of organizations to which tax exemption is applicable. Subsection 501(c)(19) describes veterans organizations as one such entity and reads as follows: ". . . . a post or organization of past or present members of the Armed Forces of the United States or an auxiliary unit or society of any such post or organization (A) organized in the United States or any of its possessions, (B) at least 75 percent of the members of which are past or present members of the Armed Forces of the United States and substantially all of the other members of which are individuals who are cadets or are spouses, widows, or widowers of past or present members of the Armed Forces, and (C) no part of the net earnings of which inures to the benefit of any private shareholder or individual."

Section 501(c)(19)-1(b) of the Income Tax Regulations sets forth the specific membership requirements for veterans organizations and reads, in part, "In order to be described in section 501(c)(19), an organization must meet the membership requirements of section 501(c)(19)(B) and this paragraph. The first requirement is that at least 75 percent of the members of the organization must be war veterans. The second requirement is that at least 97.5 percent of all members of the organization must be war veterans, present or former members of the United States Armed Forces, Cadets, or spouses, widows, or widowers of war veterans."

Section 4 of Rev. Proc. 80-27 outlines the requirements for inclusion in a group exemption letter and provides, in part, that "A central organization applying for a group exemption letter must establish that the subordinates to be included are all exempt under the same paragraph of section 501(c) of the Code."

ARGUMENTS/GOVERNMENT'S POSITION

The sections of the Internal Revenue Code and underlying regulations relating to the membership requirements for veterans organizations as recited above are explicit in their definition of the permissible percentage of social/guest members a veterans organization may enroll and still maintain its exempt status. In determining whether or not a veterans organization meets the legal requirements for continued recognition of exemption from Federal income tax, the Service has virtually no latitude when membership infractions occur.

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The legal requirements for recognition of exemption from Federal income tax for veterans organizations are straight forward. Such organizations are subject to membership restrictions and must comply with these constraints in order to qualify for tax-exempt status. Moreover, if a veterans organization such as an wishes to maintain its tax-exempt status, it must continue to comply with the membership restrictions which initially qualified the Post for its tax-exempt status.

With respect to subsidiary organizations recognized as exempt under the umbrella of a group ruling, the Revenue Procedure cited above (Rev. Proc. 80-27, 1980-1 C.B. 677) makes it clear that all such subsidiary organizations must meet the legal requirements for recognition of exemption in order to be included in the group ruling. The fact of holding a Charter from the national organization carries no automatic provision for inclusion in the group to which the tax-exempt status applies. That is, the Income Tax Regulations which restrict the membership qualifications for veterans organizations seeking an individual ruling letter are equally applicable to all other similar veterans organizations seeking to be included as a subsidiary under a group ruling letter.

TAXPAYER'S POSITION

The officers of this Post have stated that the Post began accepting social members due to the limited number of veterans in the area who were interested in joining the organization and continued to accept social members due to its need for financial resources in the form of membership dues. The Post's officers initially indicated that the Post was in agreement with the proposed revocation of its tax exempt status and would sign Agreement Form 6018. Subsequently, the Post engaged an attorney who began discussions of the Post's desire to correct its membership roster to comply with the membership requirements of IRC section 501(c)(19) so that the Post could retain its tax-exempt status.

CONCLUSION

The _____ is a subsidiary of the _____ and is currently recognized as exempt from Federal income tax as an organization described in Internal Revenue Code section 501(c)(19) by our group ruling letter issued to the National Headquarters. The local Post, however, is not in compliance with the veterans organization membership requirements, and has not been in compliance with such requirements for some number of years.

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Revocation of the tax-exempt status is proposed in accordance with the provisions of Internal Revenue Code section 501(c)(19) and Revenue Procedure 80-27 cited above. The proposed revocation should be effective the first day of the taxable year when these membership infractions can be documented by examination facts.

The factors leading to this conclusion are two-fold. First, the Post is not in compliance with the membership requirements for veterans organizations, and second, the Post has engaged in a pattern of activity that led to its noncompliance with the membership requirements. That is, the Post was accepting social members into its ranks as far back as the early 1990's and continued not only to accept the social members, but also actively recruited additional social members despite the availability of information suggesting that the practice should be discontinued.

With respect to the Post's desire to make correction to its membership roster and retain its tax-exempt status, the legal requirements set forth in IRC sections 501(a) or 501(c) do not provide for exceptions based on an organization's correction or remedy of the condition that caused its disqualification. In addition to the above, it appears that to permit such a correction would have the effect of relieving the Post of its responsibility of ensuring that all of its subordinate units included in the group ruling comply with the legal requirements for inclusion. There is no legal precedent to support such a decision, and no such action is recommended.

In the event the proposed revocation of the tax-exempt status is sustained, the Post will be required to file Form 1120 beginning with the taxable period ending and for all subsequent tax years. The Business Master File will be changed to reflect the Post's correct filing requirement.

ALTERNATIVE ISSUE

FACTS:

As noted earlier in this report, the Post conducted weekly bingo games as a fundraising activity to generate revenue in support of its veterans, civic, and charitable programs. As an organization recognized as exempt from Federal income tax within the meaning of Internal Revenue Code section 501(c)(19), the Post was eligible for a bingo license in the state of The Post obtained such a license and permitted the license to be used by a bingo promoter contrary to the statutes. In return for use of the bingo license, the Post was paid hall rental and clean-up fees for use of Post facilities in which to hold the bingo games.

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With respect to the Post's bingo activities, the bingo games were investigated by law enforcement officials in , and found to be conducted by a bingo promoter in violation of the state laws governing such operations in the state of . We were advised by members of the Post's Board of Directors that the bingo games were raided by law enforcement officials from in , and as a result of the law enforcement raid, the Post agreed to relinquish its bingo license, thus, effectively negating the conduct of further bingo games for at least one year and possibly longer. Consequently, the Post no longer holds its bingo games formerly conducted on a weekly basis.

The bingo games and attendant revenues are raised as an alternative issue in the event the proposed revocation of the Post's tax exempt status on the membership issue is not sustained on appeal. In particular, this section of the report addresses the question as to whether the bingo games constitute an unrelated trade or business activity subject to the unrelated business income tax.

LAW:

Internal Revenue Code section 513
Internal Revenue Code section 513(h)
Internal Revenue Code section 511
Willie Mack, Jr. and Jean A., Petitioners v. Commissioner of Internal Revenue,
Respondent, TC Memo 1989-490

The term "unrelated trade or business" is defined in Internal Revenue Code section 513 to mean, in the case of an organization subject to the unrelated business income tax (imposed by section 511), any trade or business the conduct of which is not substantially related (aside from the need for funds) to the performance or purpose constituting the basis for its exemption, with certain exceptions that are not applicable here.

Internal Revenue Code section 513(h) provides an exclusion from the term "unrelated trade or business activity," and reads, in part, "The revenues derived from bingo games operated in accordance with state and local laws where the games do not compete with other similar bingo games carried out on a commercial basis are excluded from unrelated trade or business activities."

Section 511 of the Internal Revenue Code imposes a tax at the corporate tax rates for each taxable year on the unrelated business taxable income of exempt organizations.

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In the court case of Willie Mack, Jr. v. Commissioner of Internal Revenue, the United States Tax Court addressed the issue as to whether taxpayers are entitled to deductions under Code sections 162 or 165. The Court's opinion reads, in part, as follows:

" . . . In March 1980, city police confiscated cash from a gambling raid. A sharply defined public policy against illegal gambling existed . . . during 1980. The fact of this policy is evidenced by Mack's plight. Police arrested Mack and seized his property as a result of his gambling activities. Accordingly, a loss deduction for the seized \$14,000 is denied. This Court refuses to mitigate the impact of a state's policy against illegal gambling.

ARGUMENTS/GOVERNMENT'S POSITION:

The Post's bingo activities meet the definition of an unrelated trade or business activity within the scope of Internal Revenue Code section 513. Moreover, the exclusion from the definition of an "unrelated trade or business activity" for bingo is not applicable in this case inasmuch as the bingo games were not conducted in accordance with state and local laws as required by the statute. Thus, the Post is subject to the tax imposed by Code section 511 on the revenues generated by the bingo games. In accordance with the Tax Court's position in the case of Mack v. Commissioner, no expense deductions under either section 162 or 165 should be allowed inasmuch as the government should not condone illegal activities by reducing the tax imposed on such income.

The issue of the unrelated trade or business activities resulting from the bingo games and the attendant tax was discussed with the Post's officers and is discussed here as an alternative issue in the event the Post is permitted to correct its membership deficiencies and retain its tax-exempt status. Initial emphasis in this case, however, should remain with the Post's membership weaknesses.